specific priority, therefore, could be numerically ranked depending on the matrix score. The higher ranking projects within each priority were then selected for funding in a State's annual grant request.

Kentucky's amendment would replace the site-matrix selection process with a more programmatic decisionmaking process.

All eligible sites in Kentucky would be ranked in accordance with the criteria in section 403 of SMCRA. Because priority one and two projects have been and continue to be the thrust of Kentucky's AML program, emphasis would be placed on those problem areas exhibiting an adverse impact, either present or potential, on public health, safety and general welfare. Kentucky's AML staff would evaluate each site and measure the on-site and off-site AML impacts.

All eligible priority one and two projects which have been investigated by Kentucky's AML staff would then be put on a grant development action list. The Division of Abandoned Mine Lands would select projects from this list for inclusion in the State's annual grant request. Factors considered in selecting projects for final application would be:

1. Has the project area been thoroughly investigated and scoped?
2. Has the final eligibility been resolved?
3. Does the project have local public support?
4. Is remining by private enterprise anticipated? If so, in what timeframe?
5. Has the area been investigated by OSM for potential emergency declaration? What is the likelihood of such a declaration?

OSM is requesting specific comments on the adequacy of Kentucky's new ranking and selecting procedures.

IV. Procedural Matters

The Department intends to continue to discuss the State's amendment with representatives of the State throughout the review process. All contacts between Department personnel and representatives of the State will be conducted in accordance with OSM's guidelines on contacts with States published September 19, 1979 (44 FR 54444).

Federal Paperwork Reduction Act

There are no information collection requirements in the proposed rule requiring submittal to the Office of Management and Budget under 44 U.S.C. 3507.

Executive Order 12291

The DOI has examined the proposed rule according to the criteria of Executive Order 12291 (February 17, 1981) and has determined, based on available quantitative data, that it is not major and does not require a regulatory impact analysis. The reasons underlying this determination are as follows:

1. Approval would not have any effect on costs or prices for consumers, individual industries, Federal, State or local government agencies or geographic regions; and

2. Approval would not have adverse effects on competition, employment, productivity, innovation or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.

Regulatory Flexibility Act

This proposed Flexibility Act, 5 U.S.C. 601 *et seq.*, and the Office of Surface Mining has determined that the rule would not have significant economic effects on a substantial number of small entities. The reason for this determination is that approval would not have demographic effects, direct costs, nonquantifiable costs, competitive effects, enforcement costs or aggregate effects on small entities.

National Environmental Policy Act

Further, the Office of Surface Mining has determined that the Kentucky AML Plan amendment does not have a significant effect on the quality of the human environment because the decision relates only to the policies, procedures and organization of the State's Abandoned Mine Land Reclamation Program. Therefore, OSM has determined that this rule is categorically excluded from compliance with the National Environmental Policy Act in accordance with 40 CFR 1507.3.

As a result, no environmental assessment (EA) or environmental impact statement (EIS) has been prepared on this action. It should be noted that a programmatic EIS has been prepared by OSM in conjunction with the implementation of Title IV in general. Moreover, an EA or an EIS will be prepared for the approval of grants for the abandoned mine land reclamation projects under 30 CFR Part 886.

List of Subjects in 30 CFR Part 917

Coal mining, Noncoal reclamation, Surface mining, Underground mining.

Accordingly, it is proposed that 30 CFR Part 917 be amended as set forth below.

Dated: February 9, 1986.

James E. Cason,

Deputy Assistant Secretary for Land and Minerals Management.

PART 917—KENTUCKY

1. The authority citation for Part 917 continues to read as follows:

Authority: Pub. L. 95-87, Surface Mining Control and Reclamation Act of 1977 (30 U.S.C. 1201 *et seq.*)

2. § 917.21 is amended by designating existing text as paragraph (a) and adding a new paragraph (b) to read as follows:

§ 917.21 Amendments to Approved Kentucky Abandon Mine Land Reclamation Plan.

* * * * *

(b) The Kentucky Abandoned Mine Reclamation Amendment, as submitted on March 25, 1985, is approved. Copies of the approved plan are available at the following locations:

Office of Surface Mining Reclamation and Enforcement, 340 Legion Drive, Suite 28, Lexington, Kentucky 40504

Kentucky Department of Natural Resources and Environmental Protection, Frankfort, Kentucky 40601

Office of Surface Mining Reclamation and Enforcement, Administrative Record, Room 5315, 1100 "L" Street, NW., Washington, DC 20240.

[FR Doc. 86-3411 Filed 2-19-86; 8:45 am]

BILLING CODE 4310-05-M

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 180

[PP 2F2709/P385; FRL-2971-9]

Pesticide Tolerances for Fluridone

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed Rule.

SUMMARY: This document proposes that tolerances for the combined residues of the herbicide fluridone and its metabolite be established in edible fish and various raw agricultural commodities. This regulation to establish maximum permissible levels for residues of fluridone in these commodities was requested by the Elanco Products Co.

DATES: Written comments must be received on or before March 24, 1986.

ADDRESS: Written comments, identified by the document control number [PP 2F2709/P385], may be submitted to the:

Hearing Clerk (A–110), Environmental Protection Agency, 401 M Street SW., Washington, D.C. 20460.

FOR FURTHER INFORMATION CONTACT:

Richard F. Mountfort, Product Manager (PM–23), Registration Division (TS–767C), Environmental Protection Agency, 401 M Street SW., Washington, D.C. 20460

Office location and telephone number: Room 237, CM#2, 1921 Jefferson Davis Highway, Arlington, VA (703–557–1830).

SUPPLEMENTARY INFORMATION: EPA issued a notice, published in the **Federal Register** of July 28, 1982 (47 FR 32602), which announced that Elanco Products Co., Division of Eli Lilly and Co., 740 South Alabama St., Indianapolis, IN 46285, had filed pesticide petition 2F2709 to EPA. This petition proposed to amend 40 CFR Part 180 by establishing a tolerance for the combined residues of the herbicide fluridone [1-methyl-3-phenyl-5-[3-(trifluoromethyl]phenyl]-4(1*H*)-pyridinone] and its metabolite [1-methyl-3-(4-hydroxyphenyl)-5-[3-(trifluoromethyl]phenyl]-4(1*H*)-pyridinone in the commodity fish at 0.5 part per million (ppm). In the same issue of the **Federal Register** (47 FR 32602), EPA announced receipt of a concurrent proposal from Elanco to amend 21 CFR Part 193 by establishing a food additive regulation permitting residues of fluridone in potable water at 0.15 ppm. In the **Federal Register** of March 30, 1983 (48 FR 13256), EPA announced that Elanco had amended pesticide petition 2F2709 by proposing tolerances for residues of fluridone in or on:

1. Eggs, fat, meat, and meat byproducts (except liver and kidney) of cattle, goats, hogs, horses, poultry, sheep, and milk at 0.05 ppm.

2. Liver and kidney of cattle, goats, hogs, horses, poultry, and sheep at 0.1 ppm.

The petitioner had further amended the petition by proposing tolerances for the herbicide in or on the commodities citrus, cucurbits, fruiting vegetables, grain crops, leafy vegetables, nuts, pome fruit, root crop vegetables, seed and pod vegetables, small fruit, and stone fruit at 0.05 ppm and forage grasses and legumes at 0.15 ppm.

The petitioner later revised the proposed levels for the above-listed crop groupings, except forage grasses and legumes, to 0.1 ppm and included the specific commodities avocados, cottonseed, and hops at 0.1 ppm. These proposals apply to residues of fluridone transferring to these commodities through irrigation water.

Because of a change in procedures, the Agency is not establishing food additive regulations for pesticides that are directly added to potable water (47 FR 25746; June 15, 1982). The Agency is evaluating the safety of such residues under the authority of the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA), as amended, and the Safe Drinking Water Act (SDWA) to ensure that an acceptable residue level is not exceeded and that provisions of the SDWA are met.

The data submitted in the petition and other relevant material have been evaluated. The data include a rat acute-oral median lethal dose (LD_{50}) of >10,000 milligrams per kilogram (mg/kg); an Ames test, negative at the level of test compound solubility (2,000 μg/plate); an Unscheduled DNA Synthesis (UDS) assay in rat hepatocytes, negative; a Sister Chromatid Exchange (SCE) assay in Chinese hamster bone marrow, negative; a rabbit teratology study with a teratogenic no-observed-effect level (NOEL) of 750 mg/kg/day and a NOEL for fetotoxicity of 125 mg/kg/day; a 3-generation rat reproduction study with a NOEL for reproductive effects of 650 ppm (35 mg/kg of body weight (bwt)); a 2-year rat chronic feeding/oncogenicity study with a NOEL of 200 ppm (8 mg/kg/day) and no establised dose-related oncogenic response for any level up to and including the highest dose tested (2,000 ppm, 81 mg/kg/day) (this study is discussed further below); a 2-year mouse oncogenicity study with increased incidences of skin fibrosarcomas in females at 330 ppm (49 mg/kg/day, highest dose tested [HDT]) (this study is also further discussed below); and a 1-year dog feeding study with a NOEL of 75 mg/kg/day.

In the 2-year rat study, there were observed increased incidences of skin papillomas and mononuclear cell leukemia (MCL) in some treatment groups of male rats. After careful consideration of complete histopathological findings reported, including historical data for controls of the strain (Fisher 344 rat) and the laboratory conducting the study, the Agency's conclusion is that these results did not indicate an oncogenic response to the test chemical and were within spontaneous levels reported for control animals. The papillomas do not represent a life-threatening lesion and there is no evidence that treatment resulted in malignant transformation or progression to squamous cell carcinomas of the skin. Because of smallness in size, half the skin masses diagnosed grossly were lost before histological examination. Considering only those papillomas which were histopathologically confirmed, the incidences do not support a compound-related effect.

High mortality among males at 2,000 ppm (HDT) confounded initial evaluation of an apparent trend, although not statistically significant, toward a dose response for MCL in surviving male rats. After broadening consideration of the effect to include animals not surviving, as well as those surviving to term, the apparent trend is no longer evident. The incidence of MCL in fluridone-treated rats fell within the range of historical control data for MCL observed in this and other testing laboratories. The Agency, thus, concludes that the occurrence of MCL in male rats was not related to fluridone admininstration.

In the mouse oncogenicity study, the Agency concludes that the increased incidence of skin fibrosarcomas in high-dose females was not biologically significant. Two studies were performed one week apart with discrete populations of animals on test, including separate controls. A statisticially significant increase for the combined incidences of fibromas and fibrosarcomas in the high dose females as compared to control females was reported for only one of the studies. The statistically significant increase in the one study may reflect a lower spontaneous incidence of the lesion in its control animals compared with historical data for the strain and laboratory. There was no corresponding increased incidence of other subcutaneous tumors, such as mammary gland tumors in treated females, and treatment did not appear to shorten time-to-tumor appearance (no effect on longevity).

Moreover, the fibrosarcomas were larger in size in control than in treated groups. The fibrosarcomas of treated mice showed no evidence of greater cellular anaplasia than control mice. The dose levels employed by the petitioner in the chronic mouse study [HDT 330 ppm (49 mg/kg/day)] were based on results from 90-day studies in the same strain of mouse. In these short-term studies, from 10 to 17 percent of the animals at the 330 ppm dose level exhibited centrilobular hypertrophy of the liver and relative liver weights were increased. Centrilobular hypertrophy was not produced in the liver of high dose animals in the chronic study. However, relative liver to body weight ratios were elevated in females in the high dose group at 12 months but not at 24 months. There were also increased serum alkaline phosphatase (AP) levels, and hepatic enzyme induction occurred at the 330 ppm dose level. The Agency

concludes that a maximum tolerated dose (MTD) was not achieved in this study, but that the study is adequate to satisfy the guideline requirement for a second species oncogenicity study. The Agency intends to develop criteria for determining MTD levels in toxicity studies, and applying these criteria as a generic issue.

Although the rabbit teratology study was negative and acceptable, the 1980 rat teratology study showed neither maternal nor fetal toxicity at the highest dose tested (200 mg/kg/day). Therefore, the rat study was classified as supplementary requiring a new teratology study to be performed in a second species. The petitioner is repeating this study using higher dose levels. The high dose tested in the existing study is considered a NOEL for teratogenesis in that study.

Based on the NOEL of 8 mg/kg/day in the chronic rat feeding study and a hundred-fold safety factor, the acceptable daily intake (ADI) is proposed to be set at 0.08 mg/kg/day with a proposed maximum permissible intake (MPI) of 4.8 mg/day for a 60-kg person. There are no previously established tolerances for this herbicide.

The Agency is proposing an acceptable residue level for fluridone in potable water at 0.15 ppm. This concentration reflects the maximum application rate for the herbicide described in the petition and to be permitted on approved labeling under registration(s) issued pursuant to FIFRA. Consumption of water is estimated at 2.0 liters per day for a 60-kg adult. The proposed tolerances for fish, raw agricultural commodities, secondary residues in animal tissues, and acceptable residue level in potable water would result in a theoretical maximum residue contribution of 0.4112 mg/day in a 1.5-kg diet (including 2 liters of water) and use 8.57 percent of the ADI.

The metabolism of the pesticide in irrigated crops and animals is adequately understood for the purposes of this aquatic use only, and an adequate analytical method, highpressure liquid chromatography, is available for enforcement purposes. There are no regulatory actions pending against the pesticide, and it is considered useful for the purpose for which the tolerances are sought.

Interested persons are invited to submit written comments on the proposed regulation. The comments must bear a notation indicating both the subject and the petition and document control number [PP 2F2709/P385]. All written comments filed in response to this notice of proposed rulemaking will be available for public inspection in the office of Richard Mountfort from 8 a.m. to 4 p.m., Monday through Friday, except legal holidays.

In addition to the proposed rule, and within the time period specified for comment, the Agency is also inviting comment on the proposed registration of fluridone pesticides. Applications for registration of two products containing fluridone have been submitted by Elanco Products Company. The products are Sonar A.S., a 4-pound per gallon liquid formulation, EPA file symbol 1471–RET, and Sonar 5P, a 5 percent pellet formulation, EPA file symbol 1471–REA. The Agency has evaluated the data submitted by the manufacturer and is proposing to issue registrations under the authority of section 3(c)(5) of FIFRA for use of fluridone for aquactic vegetation control in freshwater ponds, lakes, reservoirs, drainage canals, irrigation canals, and rivers.

Fluridone is the accepted American National Standards Institution name for the chemical, 1-methyl-3-phenyl-5-[3-(trifluoromethyl)phenly]-4 (1*H*)-pyridinone. The trade name for fluridone is Sonar®. Technical fluridone is a white (to off-white), odorless, crystalline solid. The chemical has a molecular weight of 329.3. Fluridone has a melting point of 154° to 155°C and a vapor pressure of $<10^{-7}$ Torr at 25 °C. Fluridone has the empirical formula $C_{19}H_{14}F_3NO$.

Environmental fate data indicate that fluridone is stable to hydrolysis. It will photograde (half-life of 34 hours in natural pond water). Under anaerobic aquatic conditions, fluridone has a half-life of 9 months. Half-life for fluridone in water is estimated to be 20 days; for hydrosoil, 90 days. Fluridone has a low potential for bioaccumulation in fish.

Environmental effects data submitted and used to evaluate fluridone include:

Avian species—an acute oral study (bobwhite quail) >2,000 mg/kg (slightly toxic); dietary studies (bobwhite quail and mallard duck) >5,000 ppm; reproduction studies with no effects for the above species up to 1,000 ppm dietary exposure.

Aquatic species—Daphnia magna 48-hour acute is 6.3 mg/L (moderately toxic); a bluegill sunfish 96-hour acute is 12 mg/L (moderately toxic); a rainbow trout 96-hour acute is 11.7 mg/L (moderately toxic); a sheepshead minnow 96-hour acute is 10.91 mg/L (moderately toxic); oyster embryo-larvae 48-hour acute is 16.51 mg/L (moderately toxic). The maximum acceptable theoretical concentration (MATC) value for fathead minnow (second generation fry) was calculated to be >0.48 <0.96 mg/L. No treatment-related effects were observed at or below 0.48 mg/L. Total length of 3-day-old fry was reduced at 2 mg/L fluridone.

The acute and MATC values indicate a potential hazard for aquatic organisms in shallow areas at the higher treatment rates. The Agency has determined that the labeling must specify that users consult their State Fish and Game Agency or the U.S. Fish and Wildlife Service before making applications in order to avoid impact on threatened or endangered aquatic plant or animal species. It is intended that private applicators be limited to use of fluridone only in small bodies of water with little or no outflow and totally under the control of the user. For other aquatic sites, application would be through programs of Federal, State or local public agencies or contractors or licensees under their direct control.

Comments may be submitted on all aspects of the Agency's proposed decision to register fluridone.

The Office of Management and Budget has exempted this rule from the requirements of section 3 of Executive Order 12291.

Pursuant to the requirements of the Regulatory Flexibility Act (Pub. L. 96–354, 94 Stat. 1164, 5 U.S.C. 601–612), the Administrator has determined that regulations establishing new tolerances or raising tolerance levels or establishing exemptions from tolerance requirements do not have a significant economic impact on a substantial number of small entities. A certification statement to this effect was published in the **Federal Register** of May 4, 1981 (46 FR 24950).

List of Subjects in 40 CFR Part 180

Administrative practice and procedure, Agricultural commodities, Pesticide and pests.

Dated: February 14, 1986.

Douglas D. Campt,

Director, Registration Division, Office of Pesticide Programs.

Therefore, it is proposed that 40 CFR Part 180 be amended as follows:

PART 180—[AMENDED]

1. The authority citation of Part 180 continues to read as follows:

Authority: 21 U.S.C. 346a.

2. Section 180.420 is added to read as follows:

§ 180.420 Fluridone; tolerances for residues.

(a) A tolerance is established for the combined residues of the herbicide fluridone (1-methyl-3-phenyl-5-[3-trifluoromethyl)phenyl]-4[1*H*)-pyridinone) and its metabolite (1-

methyl-3-(4-hydroxyphenyl)-5-[3-(trifluoromethyl)phenyl]-4(1*H*)-pyridinone) in fish at 0.5 ppm.

(b) Tolerances are established for residues of the herbicide fluridone in the following raw agricultural commodities.

Commodities	Parts per million
Cattle, fat	0.05
Cattle, kidney	0.1
Cattle, liver	0.1
Cattle, meat (except liver and kidney)	0.05
Cattle mbyp	0.05
Eggs	0.05
Goats, fat	0.05
Goats, kidney	0.1
Goats, liver	0.1
Goats, meat (except liver and kidney)	0.05
Goats, mbyp	0.05
Hogs, fat	0.05
Hogs, kidney	0.1
Hogs, liver	0.1
Hogs, meat (except liver and kidney)	0.05
Hogs, mbyp	0.05
Horses, fat	0.05
Horses, kidney	0.1
Horses, liver	0.1
Horses, meat (except liver and kidney)	0.05
Horses, mbyp	0.05
Milk	0.05
Poultry, fat	0.05
Poultry, kidney	0.1
Poultry, liver	0.1
Poultry, meat (except liver and kidney)	0.05
Poultry, mbyp	0.05
Sheep, fat	0.05
Sheep, kidney	0.1
Sheep, liver	0.1
Sheep, meat (except liver and kidney)	0.05
Sheep, mbyp	0.05

(c) Tolerances are established in the following irrigated crops and crop groupings for residues of the herbicide fluridone resulting from use of irrigation water containing residues of 0.15 ppm following applications on or around aquatic sites. Where tolerances are established at higher levels from other uses of fluridone on the following crops, the higher tolerance also applies to residues in the irrigated commodity. The tolerances follow:

Commodities	Parts per million
Avocados	0.1
Citrus	0.1
Cottonseed	0.1
Cucurbits	0.1
Forage grasses	0.15
Forage legumes	0.15
Fruiting vegetables	0.1
Grain crop	0.1
Hops	0.1
Leafy vegetables	0.1
Nuts	0.1
Pome fruit	0.1
Root crops, vegetables	0.1
Seed and pod vegetables	0.1
Small fruit	0.1
Stone fruit	0.1

[FR Doc. 86-3709 Filed 2-19-86; 8:45 am]

BILLING CODE 6560-50-M

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Care Financing Administration

42 CFR Part 405

[BERC-325-P]

Medicare Program; Changes to the Return on Equity Capital Provisions and the Exception From the Cost Limits for Newly-Established Home Health Agencies

AGENCY: Health Care Financing Administration (HCFA), HHS.

ACTION: Proposed rule

SUMMARY: We are proposing to amend the regulations used for computing Medicare reimbursement for certain providers of covered health care services, as follows:

- The allowance for a return on equity capital, which currently applies to all proprietary health care providers, would apply only to proprietary hospitals and skilled nursing facilities. In addition, the allowance for outpatient hospital services and skilled nursing facility services would be reduced.
- The exception to the home health agency cost limits for new agencies would be eliminated.

DATE: To be considered, comments must be mailed or delivered to the appropriate address, as provided below, and must be received by 5:00 p.m. March 24, 1986.

ADDRESS: Mail comments to the following address: Health Care Financing Administration, Department of Health and Human Services, Attention: BERC-325-P, P.O. Box 26676, Baltimore, Maryland 21207

If you prefer, you may deliver your comments to one of the following addresses:

Room 309-Hubert H. Humphrey Bldg., 200 Independence Ave. SW., Washington, DC,

or

Room 132 East High Rise Bldg., 6325 Security Blvd., Baltimore, Maryland.

In commenting, please refer to BERC-325-P.

Comments will be available for public inspection as they are received, beginning approximately three weeks after publication of this document, in Room 309-G of the Department's offices at 200 Independence Ave., SW., Washington, DC on Monday through Friday of each week from 8:30 a.m. to 5:00 p.m., phone (202) 245-7890.

FOR FURTHER INFORMATION CONTACT: Return on Equity Capital: Anthony Coates, (301) 597-2886; Elimination of New HHA Exception: Steve Kirsch, (301) 594-9465.

SUPPLEMENTARY INFORMATION:

I. Modifications to Return on Equity Capital

Section 1861(v) of the Social Security Act (the Act) defines "reasonable cost" and provides that the necessary costs incurred by a provider (both direct and indirect) in the delivery of covered health care services are included in this definition. A return on equity capital is paid as an allowance in addition to the reasonable cost of covered services furnished to beneficiaries by proprietary providers.

Section 7 of Pub. L. 89-713, enacted November 2, 1966, added what is now section 1861(v)(1)(B) to require the Secretary to prescribe regulations that provide for the recognition of a reasonable return on equity capital for extended care services furnished to Medicare beneficiaries by proprietary facilities (skilled nursing facilities (SNFs)). The legislative history expressed congressional concern that a return on equity capital was necessary for the following reasons:

- As a means of saving Medicare Part A trust funds, Congress wanted to encourage the transfer of hospital patients to SNFs when further hospitalization was no longer necessary.
- It was doubtful whether nonprofit organizations would be able to provide a sufficient number of beds to meet the needs of the aged.
- Private investors in SNF facilities should be guaranteed a fair return on the money that they put into the operation.

112 Cong. Rec. 28.220 (1966) (Statement of Rep. Byrnes).

In addition, the conference committee report (H.R. Rep. No. 2317, 89th Cong., 2nd Sess. 3 (1966)) suggested that proprietary hospitals should be treated comparably to proprietary SNFs with respect to the return on equity capital provisions.

In response to these congressional concerns, we issued what is now 42 CFR 405.429 on November 22, 1966 (31 FR 14816). Under section 1861(v)(1)(B) of the Act, the Secretary determined that SNFs, the primary provider of extended care services, should receive an allowance for the net equity of the capital invested by private owners. Section 405.429 provides that the return on equity capital provisions apply not only to proprietary SNFs but also to all other proprietary providers (which, at that time, encompassed hospitals and home health agencies (HHAs)).

Subsequent to that time, the Medicare program has recognized other proprietary health care providers and entities (comprehensive outpatient rehabilitation facilities (CORFs), providers of outpatient physical therapy and speech pathology services (OPTs), independent organ procurement agencies (OPAs), histocompatability laboratories (Histo-Labs), and rural health clinics (RHCs)) to which the provisions in § 405.429 apply. For purposes of discussion below, when we use the term "providers", that term encompasses both "providers" and "entities" that furnish health care services to beneficiaries under the Medicare program.

The annual rate of return, paid on this investment relative to all provider services furnished to Medicare beneficiaries, is calculated by applying a percentage equal to one and one-half times the average of the rates of interest on special issues of public debt obligations issued for purchase by the Medicare Part A Trust Fund. This rate, as prescribed in § 405.429, is the *maximum* amount allowed for return on equity to SNFs under section 1861(v)(1)(B) of the Act.

Section 601(e) of Pub. L. 98–21 amended section 1886 of the Act by adding section 1886(g)(2), which provides that, effective with cost reporting periods beginning on or after April 20, 1983, the Secretary's return on equity capital provisions apply to inpatient hospital services but that the allowable return for those services is reduced from a percentage equal to one and one-half times to one times the average of the rates of interest on special issues of public debt obligations issued for purchase by the Medicare Part A Trust Fund. It is noteworthy that this is the only amendment to the Medicare provisions of the Social Security Act that has ever explicitly addressed the payment of a return on equity capital for proprietary hospitals.

A. Elimination of the Return on Equity Capital for Proprietary Providers Other than Hospitals and SNFs

Congress has provided allowances for a return on equity capital to specified proprietary providers (SNFs and hospitals). In addition, under section 1881(b)(2)(C) of the Act, the Secretary has the authority to provide an allowance for a return on equity capital to end-stage renal disease (ESRD) facilities. However, in establishing a prospective payment system for ESRD facilities (48 FR 21254 (1983)), we excluded an allowance for equity capital from the composite rates used in determining the ESRD prospective payment rates. We did so because the inclusion of a return in the rate base for ESRD facilities would weaken the incentives established through the prospective payment rates (48 FR 21261 (1983)). These facilities are expected to earn a return on investment by reducing per treatment costs below their payment rates through management efficiencies.

There has been no congressional interest expressed as to whether or not a return on equity capital should be paid to classes of providers as they come to be recognized under the Medicare program (other than to SNFs, hospitals, and ESRD facilities). However, the interpretation of the current regulatory provisions at § 405.429 has permitted application of the return on equity capital provisions to other classes of proprietary providers in addition to SNFs and hospitals. We reasoned that as new classes of providers entered the Medicare program, it was necessary to provide sufficient incentives so that private owners would be willing to invest in them to ensure that an adequate number of items and services would be made available to Medicare beneficiaries.

As noted above, it was the stated intent of Congress that proprietary SNFs and hospitals be allowed a return on equity capital. For these providers, the purpose was to ensure that an adequate number of beds were available by providing the necessary monetary incentives for investment. With respect to other providers for which Congress has not expressed similar concern or an intent that a return on equity capital be allowed, we believe it is no longer appropriate to allow such a return. We believe that the reimbursement rates paid are adequate to maintain the availability of such services to beneficiaries.

In addition, the Department's Office of the Inspector General (OIG) issued a report recommending that we discontinue providing an allowance for a return on equity capital to providers other than hospitals and SNFs (Audit Control No. 09–32607, October 12, 1983).

B. Reduction to the Rate of Return on Equity Capital for SNFs and Outpatient Hospital Services

Section 1861(v)(1)(B) of the Act requires that the level of the rate of return on equity capital for SNFs does *not exceed* one and one-half times (150 percent) the average of the rates of interest on obligations issued for purchase by the Medicare Part A Trust Fund. The 150 percent level, which is the maximum level, applies to both SNFs and outpatient hospital services as provided in § 405.429, whereas inpatient hospital services are reimbursed at a 100 percent level. The lower level for inpatient hospital services was mandated by Congress under section 1886(g)(2) of the Act, effective with cost reporting periods beginning on or after April 20, 1983. We do not have the discretion to raise or lower this level.

We believe, however, that the disparity in reimbursement levels between that for inpatient hospital services on the one hand and that for SNFs and outpatient hospital services on the other, can no longer be justified for the following reasons:

- For inpatient and outpatient hospital services and hospital-based SNF services, the same capital plant and equipment (for example, laboratory or radiology equipment) may be used without regard to the incentives of the investors or benefits obtained from the capital investment.
- There seems to be no good reason why investors in SNFs and outpatient hospital services should receive a higher level of return based upon the setting or the type of services furnished as distinguished from the type and setting involved with inpatient hospital services.
- As noted above, section 1861(v)(1)(B) of the Act sets the 150 percent level as a ceiling. The statute does not mandate that the level be set at 150 percent. In fact, in *Humana, Inc.* vs. *Schweiker,* Civil Action No. 81–1311 (D.D.C. Aug. 19, 1982), the court noted that the legislative history of section 1861(v)(1)(B) of the Act did not impose a 150 percent level on the rate of return.
- The OIG report referred to above also recommends that the reduction to the 100 percent level, required for inpatient hospital services, be applied to the allowance for outpatient hospital services and SNFs.

II. Elimination of the Exception for Newly-Established HHAs From the Cost Limits

Section 1861(v)(1) of the Act authorizes the Secretary to set prospective limits on the costs that are reimbursed under Medicare. The limits may be applied to the direct or indirect overall costs or to costs incurred for specific items or services furnished by a Medicare provider. Regulations implementing this authority are set forth at § 405.460. In addition to establishing limits on provider costs, § 405.460(f) specifies exceptions under which providers may request relief from the cost limits. The exception for a "newly-established HHA" (§ 405.460(f)(7)) defines one of the bases for which an HHA's limits may be adjusted.

Section 405.460(f)(7), as amended July 2, 1984 (49 FR 27286), enables a newly-established HHA to file for an exception to the cost limits if it can demonstrate that—

- It has provided, under present and previous ownership for a period of less than three full years, home health care services equivalent to those that would have been covered if the agency had a Medicare provider agreement in effect;
- Its variable operating costs were reasonable in relation to its utilization during the fiscal cost reporting period for which the exception is requested; and
- Its fixed operating costs are reasonable in relation to a realistic projection of utilization to be achieved at the end of the provider's second full year of operation in the program; that is, the reporting year containing the 24th month after the start of the provider's first cost reporting period.

When the newly-established HHA exception was initially adopted in 1979, there were approximately 2,500 HHAs participating in the Medicare program. The original intent of the exception was to encourage home care by neutralizing the effects of reimbursement limits upon new health care agencies. Representatives of HHAs contended that new agencies were financially at risk because they were unable to enter the market with a sufficient patient population to generate the volume of visits required to offset their fixed costs. They maintained that initial years of growth are dependent upon establishing sound referral arrangements.

Since HHAs, unlike inpatient facilities, can enter the market with little invested capital, a new provider exemption such as that granted to new hospitals and SNFs was determined to be inappropriate. At that time, we concluded that a blanket exemption would have resulted in an unwarranted competitive advantage for new market entrants.

However, in order to encourage growth of HHAs in underserved areas, a "new-HHA" exception was established to grant relief to those new agencies whose higher initial costs of operation can be traced to low utilization associated with entering the health care market without an established referral system. HHAs that have merely changed ownership or have been operating in the health care field providing substantially the same type of services as a participating HHA to private pay patients have not qualified under this section.

Subsequent to the creation of this exception in 1979, the number of participating HHAs has dramatically increased to over 5,000 in 1984. This significant increase is partially the outgrowth of a legislative change to section 1861(o) of the Act that relaxed the licensure requirements for proprietary HHAs (section 930(n)(2) of the Omnibus Budget Reconciliation Act of 1980 (Pub. L. 96–499)). From July 1, 1981, when the proprietary licensure requirement was deleted, to July 1, 1984, approximately 1700 new agencies were approved for participation in Medicare. While the new-HHA exception was intended to be the catalyst in promoting the expansion of new health care agencies, this unanticipated statutory amendment has vastly accelerated market growth since 1981. The average annual rate of growth of participating HHAs between 1981 and 1984 (14 percent) was twice that experienced between 1979 and 1981 (seven percent).

We believe it desirable for all new agencies to nonitor their costs and growth in each discipline, to institute sound management planning and to make prudent management decisions to minimize the disallowance of costs due to cost limitations. Therefore, elimination of the "new HHA" exception is intended to prevent the sheltering of inefficient providers and to reduce inappropriate payment from the Medicare Trust Fund to these agencies. Continuing to recognize higher costs simply because an HHA is "new" may merely support the ongoing operation of certain HHAs that otherwise are not viable enterprises. Payments for higher costs based on exceptions granted to new agencies result in increased expenditures, exacerbating the fiscal problems of the Medicare Trust Fund. Therefore, considering the recent increase in the number of HHAs nationwide, and the need to protect the Trust Fund from unnecessary expenditures, we believe continuation of this specific exception would be an imprudent decision.

In addition, as a result of the influx of new agencies, many established providers located in areas where the beneficiary population does not support additional agencies have become more vocal in expressing their belief that they are disadvantaged by the new-HHA exception, which they believe subsidizes a newly-established agency. They argue that this provision absolves health care providers expanding into the home care market from assuming the normal risk of opening a new business enterprise and diminishes the need for sound management planning. Since many of the costs directly related to initial development are start-up and organizational costs reimbursable under the Medicare program, established agencies contend that the new-HHA exception provides a program subsidy where none is warranted. They believe that other costs that are directly related to patient care are controllable through careful management planning.

For these reasons, we believe that our original justification for establishing a distinct exception for new HHAs is no longer valid. Therefore, we are proposing to eliminate this exception. We note that § 405.460(f) contains other exception provisions that would continue to apply to all HHAs.

III. Summary of Proposed Regulations

A. Return on Equity Capital Modification

We are proposing to amend § 405.429(a) to provide that, applicable with cost reporting periods beginning on or after the effective date of the final rule, the allowance for a return on equity capital applies only to proprietary hospitals and SNFs. These provisions would no longer apply to proprietary HHAs, CORFs, OPTDs, OPAs, Histo-Labs, and RHCs.

In addition, we are revising § 405.429(a) to reduce the rate of return on equity capital for SNFs and outpatient hospital services to the same rate as that which applies to inpatient hospital services.

We are also proposing to make a clarifying change in § 405.402(f) to conform the language in this section with that in the proposed § 405.429(b).

B. Elimination of Exception to the Cost Limits for Newly-Established HHAs

We are proposing to remove § 405.460(f)(7), applicable with cost reporting periods beginning on or after the effective date of the final rule, because we believe that an exception to the cost limits for newly-established HHAs is no longer appropriate.

IV. Regulatory Impact Statement

A. Introduction

Exeuctive Order 12291 requires us to prepare and publish a regulatory impact analysis for regulations that are likely to have an annual effect on the economy of $100 million or more; cause a major increase in costs or prices for consumer, individual industries, Federal, state or local government agencies, or geographic regions; or result in significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-

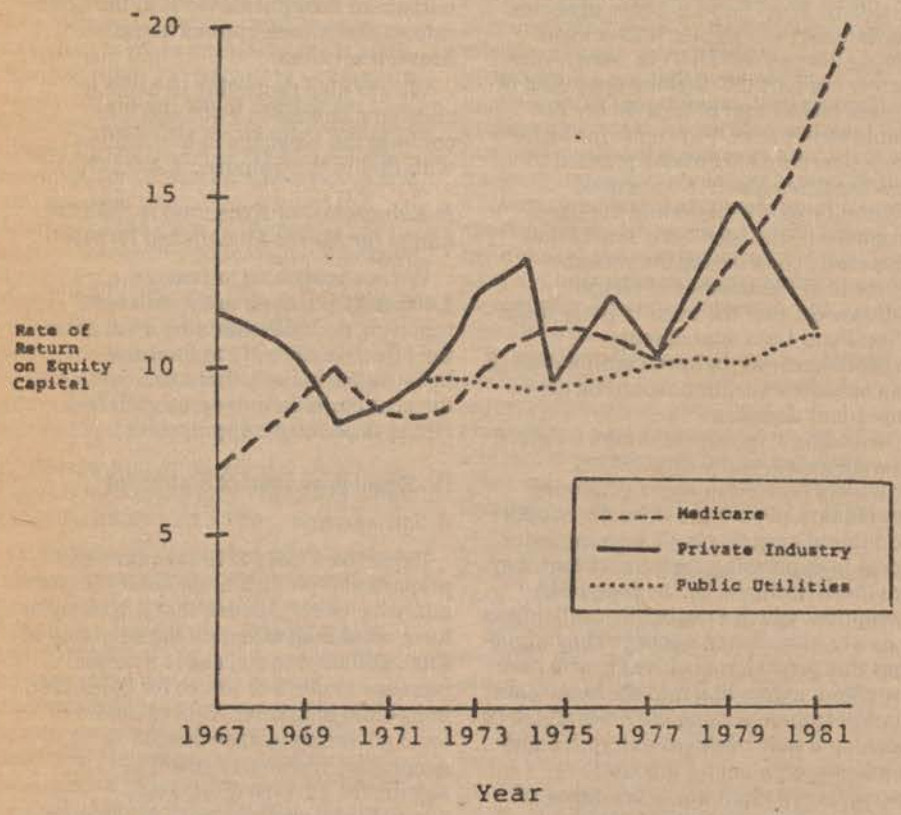
based enterprises in domestic or export markets. In addition, the Regulatory Flexibility Act, Pub. L. 96–354 (5 U.S.C. 605(b)), requires us to prepare and publish a regulatory flexibility analysis for regulations unless the Secretary certifies that the regulations will not have a significant economic impact on a substantial number of small entities.

We have determined that a regulatory impact analysis is not required for this proposed rule. However, in the following discussions regarding the return on equity capital and the exception for newly-established HHAs provisions, we are providing a voluntary regulatory flexibility anlaysis because both proposals are marked changes from our current policies and because we expect numerous comments from the affected portions of these industries regarding the expected impacts of these proposed changes.

B. Modifications To Return on Equity

As is noted in the OIG report, "Medicare has paid the return on equity capital at the highest rate allowed by law . . . The rate of increase in Medicare return on equity capital payments in recent years seems excessive when compared to the historical profit patterns (that is, increased) of both private industry generally and the public utilities segment of it." The OIG report compared the Medicare return on equity rates with the after-tax profits earned by 950 private industries as reported by The Value Line Investment Survey from 1967 through 1981, and with those earned (since 1972) by the public utilities included in the overall industry figures. The rates of return are presented below and support the OIG finding and the need for a change in policy, accordingly.

COMPARISON OF MEDICARE, PRIVATE INDUSTRY AND PUBLIC UTILITY RATES OF RETURN



1. Impact on Providers

We expect this proposed change to result in both budget savings to the Federal government and in economic effects on proprietary providers. We believe that any adverse economic consequences would be mitigated, in great part, by several viable options available to proprietary providers to create necessary amounts of equity capital for improvements or expansion of existing facilities and equipment.

If this rule had an effective date of October 1, 1985, we estimate that fiscal year (FY) 1986 savings would have been:

Proprietary Provider	Dollars medicare savings (millions)
Hospital outpatient	[1] 10.4
SNFs	[1] 13.0
HHAs	[2] 7.5
CORFs	[3]
OPTs	[3]
RHCs	[3]
OPAs	[4]
Histo-Labs	[3]

[1] Assumes a reduction from 150 percent to 100 percent of the average of the rates of interest on special issues of public debt obligations issued for purchase by the Medicare Part A Trust Fund. Also, assumes increasing savings in future years.

[2] Assumes elimination of the return on equity allowance. Also, assumes increasing savings in furture years.

[3] Due to absence of cost report data, impact is inestimatable.

[4] Assumes elimination of the return on equity allowance. Savings estimated to be no more than $100,000.

These estimated savings would result from either the elimination of or reduction of reimbursement for affected providers' return on equity allowances. Our data and those of the American Hospital Association (*Hospital Statistics*, 1984), indicate that affected proprietary hospitals represent about 11 percent of participating hospitals; affected proprietary SNFs represent about 66 percent of those approved for participation; affected proprietary HHAs represent about 28 percent of participating home health agencies; and, that most OPTs and a few RHCs would be affected. CORFs, OPAs, and Histo-Labs are primarily non-profit organizations and would not be significantly affected by this proposal.

Since it is clear that a substantial number of some proprietary providers are affected, we examined available information to determine whether the impacts would be significant for any of these groups of providers. ("Significance" can be measured, for example, in terms of a relative impact on provider's income, whether one's competitive status is affected adversely; or, whether a provider's ability to invest in its future growth is hindered).

Hospitals. We believe that proprietary hospitals would be affected directly by the reduction in their apportioned allowance for outpatient hospital services. However, under our proposed policy, proprietary hospitals would still be reimbursed adequately (one-hundred percent instead of one-hundred fifty percent of the average of the rates of

interest on obligations issued for purchase by the Medicare Part A Trust Fund) for a reasonable return on equity.

Furthermore, the economic impact of this reduction could be mitigated by proprietary hospitals' use of alternative forms of financing to help create necessary amounts of new equity. For example, many financial analysts are predicting that during the next several years, investor-owned hospital management companies will continue to generate strong earnings from their stocks. These earnings should compensate for some of the financial impact incurred by these hospitals from our reducing their equity allowance and should contribute toward the financing of capital replacement or improvement projects.

Another potential effect on some hospitals, and on our projected budget savings, could result from certain hospitals incurring the expense related to debt financing of capital replacement and improvement projects. Hospitals, and other providers, might find this alternative attractive because interest on capital indebtedness is considered an allowable cost under our cost reimbursement principles. This example of a possible shift of financing mechanisms to one that is reimbursed by Medicare, could increase the financial debt of some hospitals as well as reduce some of the estimated savings generated by this proposal. However, we cannot estimate either the number of providers that would elect this financing alternative or the amount of estimated savings that would be offset by the shift to debt financing.

SNFs. Proprietary SNFs also face a reduction in their apportioned allowance for return on equity, which would reduce Medicare income to affected proprietary SNFs. The significance of this impact for any particular SNF would depend, in great part, on two factors: whether a SNF is hospital-based or freestanding; and, the amount of Medicare business that a SNF is engaged in. Hospital-based SNFs have access to more alternative sources of capital funding to offset this payment reduction than do freestanding SNFs. On the other hand, urban hospital-based facilities have the highest SNF Medicare use rate (34 percent (Urban Institute Medicare *SNF Cost Study, 1985*)), and would experience, correspondingly, a greater reduction in revenue than SNFs with lower Medicare utilization. Thus, while being small in number relative to the number of participating freestanding SNFs, these facilities are an important source of care for Medicare patients.

While recongnizing that proprietary SNFs would be affected, we conclude that the economic effect would not be significant for the following reasons. First, we would continue to reimburse each SNF an apportioned amount of equity sufficient to recover their reasonable costs incurred in furnishing services to Medicare beneficiaries. Second, proprietary SNFs that are chain affiliates generally have access to alternative forms of financing, like issuing stocks on the open market. Finally, we believe that incentives for timely discharge from hospital care, coupled with the continued growth of the portion of the population likely to use SNF services, will tend to increase the market demand for SNF services. This trend in turn will provide sufficient incentive for interested parties to invest in the creation of new SNFs and the expansion of existing facilities.

HHAs and OPTs. The return on equity allowance would be eliminated for proprietary HHAs. If the effective date of this rule were October 1, 1985, we estimate the financial impact would have been a reduction of $7.5 million in Medicare revenue to certified proprietary HHAs in FY 1986. (We cannot quantify an estimate for OPTs). As with SNFs, the significance of this reduction, in individual cases, is relative to whether an HHA is hospital-based or freestanding and to its percentage of Medicare utilization.

We do not believe that the estimated $7.5 million reduction in Medicare reimbursement is significant relative to the Medicare revenue of HHAs. Furthermore, most HHAs are not capital-intensive in their operation and, in fact, many HHAs lease their facilities and thus are not dependent on a return on equity payment to operate and remain competitive.

Many OPTs are organized as proprietary entities and would be impacted by this proposal. However, due to the absence of adequate cost report data form certified OPTs, we cannot quantify possible effects resulting from this proposal. We do believe that affected OPTs would face a reduction in Medicare revenues, but this impact could be offset by several alternatives including expanded affiliation with HHAs or pursuing the use of alternative forms of financing, such as debt financing. Thus, in the absence of adequate information, we cannot estimate for certain the potential effects of the elimination of the return on equity allowance, but we believe that there are viable options available for OPTs to mitigate potential negative impacts.

CORFs, OPAs, Histo-Labs, and RHCs. Most CORFs, OPAs, Histo-Labs, and RHCs are not-for-profit entities and, as such, are not affected by this proposal. While the few proprietary CORFs would not receive return on equity reimbursement, along with the affected RHCs, we believe that for the following reasons the need to eliminate this payment outweights reasons for retaining it. First, as noted in section I.A. of the preamble, there are generally a sufficient number of providers and practitioners to provide access to needed services for Medicare beneficiaries. Second, we believe that a growing beneficiary population coupled with the need to provide cost effective, outpatient care to Medicare beneficiaries would provide sufficient incentive for these providers to remain competitive through additions to, or expansion of, their business activities. Therefore, we believe that CORFs, OPAs, Histo-Labs, and RHCs would not be significantly impacted.

C. Elimination of the Exception for Newly Established HHAs From the Cost Limits

As stated previously in this preamble, the initial reason for providing the exception to the cost limits for new HHAs was to minimize financial barriers to HHAs wanting to enter Medicare markets for the first time, especially in underserved areas. However, because of the rapid increase in the number of new HHAs that have entered the market following the adoption of more lenient licensure requirements for proprietary HHAs, this rationale no longer appears to be valid. Such recent increases raise questions about the actual existence of financial barriers to market entry.

Additional evidence, suggesting that financing may no longer be a significant obstacle to entering the market place, is the changing composition of new HHAs. In FY 1980 (the first year of the "new HHA" exception), slightly more than one-half (57.7 percent) of all the new HHAs certified under Medicare were either hospital-based or proprietary agencies, which then represented less than 25 percent of the total Medicare participating HHAs. In FY 1981, the percentage of new hospital-based and proprietary agencies entering the market increased to 61.7 percent. By the end of FY 1985, slightly more than 80 percent (81.1 percent) of all new agencies being certified for participation in the Medicare program were either hosptial-based or proprietary. We expect this trend to continue for the foreseeable future.

As explained above in our discussion of the effects of lowering the return on equity allowance for SNFs, we believe

that eight out of ten new agencies (hospital-based or proprietary agencies) have access to alternative sources of financing that are not available to nonprofit agencies, which dominated the home health industry prior to 1981. Moreover, hospital-based HHAs (which comprise nearly 40 percent of the new market entrants) enter with an established market, thereby further minimizing the need for the financial relief intended by the "new HHA" exception. Also, hospital-based programs can significantly reduce their start-up costs for service delivery by utilizing existing staff and facilities to perform patient care services.

While hospital-based and proprietary agencies may have access to financial resources and patient populations that nonprofit and free-standing agencies may not have, we believe that the service delivery mode and the relatively small capital investment required to start an agency make it quite easy for new free-standing and nonprofit agencies to come into the Medicare market without the aid of a "new HHA" exception. On average, capital-related costs for an HHA represent less than three percent of its total operating costs. By comparison, capital-related costs for the average SNF will be three times as much as for an HHA. Also, the nature of home health services enables HHAs to adopt extremely flexible staffing patterns and to maintain minimal fixed assets, thereby giving them a degree of control over their costs during the initial years of service that hospitals and SNF do not have.

We are presently unable to quantify the savings that may result from the proposed elimination of the "new HHA" exception. Historically, exception amounts requested by new providers have ranged from less than $1,000 to over $100,000, with an average request of $20,000. The amount approved, however, frequently is lower than the amount requested, sometimes by as much as 50 percent. Yet, because most exceptions that we approve are interim approvals, pending audit, we do not know what the final exception amounts will be. Thus far, we have very few "final" exceptions. In addition, the rapid growth of the home health agency industry makes prediction of number of future "new HHA" exceptions very uncertain. Also, the total number of HHAs affected by elimination of the "new HHA" exception is likely to be small, since all agencies would continue to be eligible to apply for other exceptions under § 405.460(f).

Based on program experience, we expect the amount of monies involved in the elimination of this exception to be insignificant in relation to overall average Medicare revenues to HHAs.

D. Summary

As stated above, we find no indications that any of the three provisions would meet the threshold criteria noted in the Executive Order or in the Regulatory Flexibility Act. Therefore, we conclude, and the Secretary certifies under 5 U.S.C. 605(b), that these proposed rules would not result in a significant economic impact on a substantial number of small entities.

E. Paperwork Reduction Act

These proposed changes would not impose information collection requirements; consequently, they need not be reviewed by the Executive Office of Management and Budget under the authority of the Paperwork Reduction Act of 1980 (44 U.S.C. 3501–3511).

V. Other Required Information

A. Public comments

Because of the large number of pieces of correspondence we normally receive on a proposed rule, we are not able to acknowledge or respond to them individually. However, in preparing the final rule, we will consider all comments that we receive by the date specified in the "Dates" section of this preamble, and, if we decide to proceed with a final rule, we will respond to the comments in the preamble of that final rule.

List of Subjects in 42 CFR Part 405

Administrative practice and procedure, Health facilities, Health maintenance organizations (HMO), Health professions, Kidney diseases, Laboratories, Medicare, Reporting and recordkeeping requirements, Rural areas, X-rays.

We are proposing to amend 42 CFR Part 405 as set forth below:

PART 405—FEDERAL HEALTH INSURANCE FOR THE AGED AND DISABLED

A. Subpart D is amended to read as follows:

Subpart D—Principles of Reimbursement for Providers, Outpatient Maintenance Dialysis, and Services by Hospital-Based Physicians

1. The authority citation for Subpart D continues to read as follows:

Authority: Secs. 1102, 1814(b), 1815, 1833(a), 1861(v), 1871, 1881, 1886, and 1887 of the Social Security Act as amended (42 U.S.C. 1302, 1395f(b), 1395g, 1395l(a), 1935x(v), 1395hh, 1995rr, 1995ww, and 1395xx).

2. Section 405.402 is amended by revising paragraph (f) to read as follows:

§ 405.402 Cost reimbursement; general.

* * * * *

(f) A return on the equity capital of propietary facilities, as described in § 405.429, is an allowance in addition to the reasonable cost of covered services furnished to beneficiaries by profit-making organizations.

* * * * *

3. Section 405.429 is amended by revising paragraph (a); redesignating the current paragraph (b) as paragraph (c); adding a new paragraph (b); and revising the redesignated paragraph (c)(1) to read as follows:

§ 405.429 Return on equity capital of proprietary providers.

(a) *Definition.*

Proprietary providers. For the purposes of this section the term "proprietary provider" means a provider that is organized and operated with the expectation of earning a profit for its owners (as distinguished from a provider that is organized and operated on a nonprofit basis). Proprietary providers may be sole proprietorships, partnerships, or corporations. Effective for cost reporting periods beginning on or after [the effective date of the final rule], proprietary providers, for the purposes of this section, includes only proprietary hospitals and SNFs.

(b) *General rule.* A reasonable return on equity capital invested and used in the provision of patient care is paid as an allowance in addition to the reasonable cost of covered services furnished to beneficiaries by proprietary providers.

(1) *Rate of return applicable to all proprietary providers for cost reporting periods beginning before [the effective date of the final rule].* Except as provided in paragraph (b)(2) of this section for inpatient hospital services, the amount allowable on an annual basis, for cost reporting periods beginning before [the effective date of the final rule], is determined by multiplying the provider's equity capital by a percentage equal to one and one-half times the average of the rates of interest on special issues of public debt obligations issued for purchase by the Medicare Part A Trust Fund for each of the months during the provider's reporting period or portion thereof covered under the program.

(2) *Rate of return related to inpatient hospital services furnished by proprietary hospitals for cost reporting*

periods beginning on or after April 20, 1983. For cost reporting periods beginning on or after April 20, 1983, the amount allowable in determining the return related to inpatient hospital services is determined using a percentage equal to the average of the rates of interest as described in paragraph (b)(1) of this section.

(3) *Rate of return related to proprietary SNFs and outpatient hospital services furnished by proprietary hospitals for cost reporting periods beginning on or after [the effective date of the final rule].* For cost reporting periods beginning on or after [the effective date of the final rule], the amount allowable in determining the return related to SNFs and outpatient hospital services is determined using a percentage equal to the average of the rates of interest as described in paragraph (b)(1) of this section.

(c) *Application*—(1) *Computation of equity capital.* For purposes of computing the allowable return, the provider's equity capital means—

(i) The provider's investment in plant, property, and equipment related to patient care (net of depreciation) and funds deposited by a provider who leases plant, property, or equipment related to patient care and is required by the terms of the lease to deposit such funds (net of noncurrent debt related to such investment or deposited funds); and

(ii) Net working capital maintained for necessary and proper operation of patient care activities. However, debt representing loans from partners, stockholders, or related organizations on which interest payments would be allowable as costs but for the provisions of § 405.419(b)(3)(ii), is not subtracted in computing the amount of equity capital in order that the proceeds from such loans be treated as a part of the provider's equity capital. In computing the amount of equity capital upon which a return is allowable, investment in facilities is recognized on the basis of the historical cost, or other basis, used for depreciation and other purposes under Part A of Medicare.

* * * * *

4. Section 405.460 is amended by removing and reserving paragraph (f)(7) as follows:

§ 405.460 Limitation on reimbursable costs.

* * * * *

(f) *Exceptions.*

* * * * *

(7) [Reserved]

* * * * *

(Catalog of Federal Domestic Assistance Programs No. 13.773, Medicare—Hospital Insurance; and No. 13.774, Medicare—Supplementary Medical Insurance)

Dated: October 30, 1985.

C. McClain Haddow,

Acting Administrator, Health Care Financing Administration.

Approved: January 23, 1986.

Otis R. Bowen, M.D.,

Secretary.

[FR Doc. 86-3551 Filed 2-19-86; 8:45 am]

BILLING CODE 4120-01-M

LEGAL SERVICES CORPORATION

45 CFR Parts 1600 and 1631

Expenditure of Grant Funds

AGENCY: Legal Services Corporation.

ACTION: Proposed rule.

SUMMARY: The proposed regulation provides that carryover funds of grant recipients, except those permitted to be used for representation of ineligible aliens pursuant to 45 CFR 1626.6(a)(3), will be expended with 1986 funds on a first-in, first-out basis. Section 112 of Pub. L. 99-190 provides that prior year funds carried over into fiscal year 1986 by the Corporation and by any recipient will be expended in accordance with Pub. L. 99-180 which appropriates 1986 funds for the Corporation. The regulation will assure that in monitoring and auditing recipients, the Corporation will be able to track carryover funds from prior years to determine that they are not being used for purposes not authorized by Congress.

DATE: Comments must be received on or before March 24, 1986.

ADDRESS: Comments may be submitted to the Office of the General Counsel, Legal Services Corporation, 400 Virginia Avenue SW., Washington, DC 20024-2751.

FOR FURTHER INFORMATION CONTACT: Michael J. Coster, Comptroller, (202) 863-1820.

SUPPLEMENTARY INFORMATION: This regulation responds to concerns that certain activities, such as grassroots lobbying, which Congress restricted in 1982, 1983, 1984, and 1985 appropriations measures would be continued into 1986 and beyond with pre-1982 carry-over funds. The Audit and Accounting Guide for Recipients and Auditors contains a short provision establishing a first-in, first-out requirement (50 FR 49276, 49283, Nov. 29, 1985). Proposed Part 1631 sets forth this requirement in greater detail and provides standards for enforcement and penalties for violations. Section 112 of Pub. L. 99-190 (99 Stat. 1185) requires LSC and its grantees to comply with current restrictions on the use of prior funds.

The proposed regulations amend Part 1600 to add three new definitions, including "control" as used in Section 7 of Chapter 1 of the Audit Guide referred to above. They permit the completion of cases on behalf of aliens commenced prior to January 1, 1983, and require recipients and subrecipients to submit an annual report documenting the expenditure of all carryover funds on a first-in, first-out basis. The report must include a statement of what efforts have been made to avoid the need for the use of LSC funds to represent ineligible aliens. A conforming amendment will be made to Part 1626 in the final regulation to require recipients to make good faith efforts to avoid the use of LSC funds to represent ineligible aliens—including a requirement for good faith efforts to ascertain whether all clients are, in fact, either citizens, or aliens lawfully within the United States.

Paragraph (a) of § 1631.5 provides for repayment to the Corporation of funds spent in violation of Part 1631, either in a lump sum or by pro rata deductions. The Office of Monitoring, Audit, and Compliance will determine which of the specified methods of repayment is reasonable and appropriate in each case after consultation with the recipient.

Section 4 clarifies the separation a recipient or subrecipient must maintain between restricted and unrestricted funds if it wants to use unrestricted funds for purposes not allowed for restricted funds.

List of Subjects

45 CFR Part 1600

Legal services.

45 CFR Part 1631

Aliens, Grant programs—Legal services.

For the reasons stated in the preamble, 45 CFR Part 1600 is proposed to be amended and new Part 1631 is proposed to be added as follows:

PART 1600—DEFINITIONS

1. Section 1600.1 is proposed to be amended by inserting these new definitions alphabetically as follows:

§ 1600.1 Definitions.

* * * * *

"Carryover funds" means any funds or support not expended at the end of a fiscal year and remaining as a program asset on the first day of the succeeding fiscal year.

"Control" means the direct or indirect ability to determine the direction of

management and policies or to influence the management or operating policies of another organization to the extent that an arm's length transaction may not be achieved.

* * * * *

"First-in, first-out basis" means a method of operation under which a recipient expends all funds carried over from a fiscal year before it expends any funds that have been made available to it for a subsequent fiscal year.

* * * * *

2. New Part 1631 is proposed as follows:

PART 1631—EXPENDITURE OF GRANT FUNDS

Sec.

Authority: Sec. 1006(b)(1)(A), 1007(a)(3) Legal Services Corporation Act, as amended (42 U.S.C. 2996e(b)(1)(A), 2996f(a)(3)); Pub. L. 99-190, 99 Stat. 1185; Pub. L. 99-180, 99 Stat. 1136

§ 1631.1 Purpose.

This part is designed to ensure the timely allocation of Legal Services Corporation (LSC) funds for the effective and economical provision of high quality legal assistance to eligible clients and to provide notice and direction to recipients of LSC funding regarding the use of carryover funds. To that end, recipients are required to expend all funds on a first in, first out basis.

§ 1631.2 Policy.

Except as specified in § 1631.3, all LSC funds and all revenue derived from the use or investment of LSC funds, including those held by separate entities that are under the control of the recipient or subrecipient or its agents or employees are required to be expended on a first-in, first-out basis.

§ 1631.3 Representation of certain aliens.

LSC carryover funds may be reserved and expended, pursuant to the provisions of § 1626.6(a)(3) (Disposition of cases involving representation of ineligible aliens) for completion of cases on behalf of aliens commenced prior to January 1, 1983.

§ 1631.4 Annual reports

Recipients and subrecipients shall provide an annual report to the Office of Monitoring, Audit, and Compliance documenting that they have complied with the provisions of § 1631.2. The report shall state whether the recipient or subrecipient represents any group or class which may include any ineligible alien and its efforts to ensure that no LSC funds are or have been used to represent ineligible aliens through such group or class representation. If the recipient or subrecipient expended funds pursuant to § 1626.6(a)(3) in the preceeding year or has reserved carryover funds pursuant to § 1631.3, it shall provide for each case:

(a) Date of case acceptance;

(b) A certified copy from each court or administrative agency in which an action has been filed or, if no such docket is available, a detailed statement of what actions have been taken with respect to any such matter, relevant dates, and the name of the forum;

(c) A list of the individual attorneys who have appeared for or otherwise represented the client, the time period during which each represented the client, the extent of direct contact each had with the client, and whether each is still an employee of the program;

(d) A statement of what efforts have been made to terminate its representation of the client(s) (consistent with relevant ethical obligations) and to find alternative funding to cover these expenditures;

(e) Estimated cost of completion, including, in separate categories, attorney costs and other costs; and

(f) Estimated date of completion.

§ 1631.5 Refunds to the Corporation.

(a) Any funds spent in violation of the provisions of §§ 1631.2 and 3 of this part shall be repaid to the Corporation in a lump sum or by one or more deductions from the recipient's grant checks for a specific number of months. The Office of Monitoring, Audit, and Compliance shall determine the amount of such repayment and which of the specified methods or repayment is reasonable and appropriate in each case after consultation with the recipient.

(b) No less than 30 days prior to the effective date for repayment either to occur or commence in accordance with paragraph (a) of this section, the Corporation shall provide written notice to the recipient of the amount of funds not expended in accordance with the provisions of §§ 1631.2 and 1631.3 of this part as well as of the method of repayment.

(c) Within ten days after receipt of the notice specified in paragraph (b), the recipient may request the President to review the determination. The President's decision shall be final.

(d) In no way shall any such reduction in LSC support be construed to affect permanently the annualized funding level of the recipient, nor shall any such reduction in LSC support to considered to be a termination or denial of refunding under 45 CFR Parts 1606 and 1625 respectively.

§ 1631.6 Separation of funds.

(a) If a recipient or subrecipient has placed funds subject to restrictions contained in a federal statute, a Corporation rule, regulation, instruction or guideline, or a grant or contract condition in the same account with funds not subject to such restrictions, all the funds in such account shall be deemed subject to the restriction.

(b) If funds in separate accounts are controlled by the same person or are under common control, and clear, objective, prior standards are not consistently followed as to what expenses will be paid from which account, all funds in all such accounts shall be subject to all the restrictions.

(c) If funds in separate accounts are controlled by the same person or are under common control, the recipient shall submit an annual report specifying the institution(s) in which the funds are held, each account number, the balance of each account, and for each account, the formal style or designation of all cases for which any expenses have been paid from the account. Such annual report must be approved by the recipient's governing body.

§ 1631.7 Dates.

The annual reports specified in §§ 1631.4 and 1631.6 shall be received by the Corporation no later than 30 days after the end of each calendar year. Initial reports shall be due no later than 30 days after the effective date of this regulation.

Dated: February 12, 1986.

John H. Bayly,

General Counsel.

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FEDERAL COMMUNICATIONS COMMISSION

47 CFR Part 73

[MM Docket No. 86-50 RM-5140]

Radio Stations; FM Broadcast Station in McCook, NE

AGENCY: Federal Communications Commission.

ACTION: Proposed rule.

SUMMARY: Action taken herein proposes the allocation of Channel 230A to McCook, Nebraska, at the request of Donna Goad, to provide the community with its third local FM service.